COHEN & GRESSER LLP

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Year-End Public Company Reporting Update

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With Halloween and Thanksgiving, thoughts naturally turn to year-end reporting obligations. Here's a brief summary of some changes in reporting requirements that will affect U.S. public companies in the coming year, as well as legislative and regulatory proposals for change and other considerations.

Some changes

CEO Pay Ratio Reporting. Beginning in 2018, companies that are not emerging growth companies, smaller reporting companies, foreign private issuers or registered investment companies will need to report the ratio between the total compensation of the company's CEO and that of the company's median employee in the prior year. This ratio and a brief description of the methodology by which it was calculated must be included in the company's proxy statement for its annual meeting. The SEC has provided helpful guidance as to sampling methods and reasonable estimates that may be used to identify the median employee and calculate that employee's compensation. The SEC has also given companies flexibility in choosing how to distinguish between employees and independent contractors (who are not included in the calculations). Employees located outside the U.S. may be excluded if such employees constitute less than 5% of the company's employees.

Pay ratio reporting may prompt additional explanations of the company's executive compensation programs in the Compensation Discussion and Analysis section of the proxy statement. Many companies also expect to receive questions from employees resulting from pay ratio disclosure, triggered either by concerns over the disparity between CEO and median employee pay, or by concerns about their own compensation in relation to the median. Overall, it may be best to plan an internal public relations campaign to prepare employees for the information.

Critical Audit Matters and Other Changes to the Audit Report. On October 23, 2017, the SEC adopted a PCAOB proposal to require public company auditors to include a discussion of so-called "critical audit matters" directly in the auditor's report. Critical audit matters (sometimes referred to as "CAMs") are those matters communicated to the audit committee that relate to accounts or disclosures that are material to the financial statements and that involved a particularly challenging, subjective or complex auditor judgment. The PCAOB expects that each audit will involve at least one critical audit matter. Companies will be well advised to discuss the possible disclosures with their auditors in advance. The disclosure requirement will be phased in gradually, beginning with audits for large accelerated filers in fiscal years ending on or after June 30, 2019, and for all other public companies in the following year. Less controversial PCAOB proposals adopted this October include disclosures concerning auditor tenure and independence and a revision to other standardized language in the auditor's report. These requirements will become effective for years ending on or after December 15, 2017, and thus will affect the upcoming annual reports of calendar year companies.

Exhibit Hyperlinking. All SEC filings made on or after September 1, 2017 must include a hyperlink to any exhibits from previous filings that are incorporated by reference.

Some proposals for change

Disclosure Effectiveness and Modernization. Pursuant to the Fixing America's Surface Transportation Act, or FAST Act, of 2015, the SEC Staff undertook a review of public company disclosure rules, with the stated goal of modernizing and simplifying requirements while continuing to provide all material information to registrants. Following most of the Staff recommendations, on October 11, 2017, the SEC proposed a number of somewhat technical rule changes to its reporting requirements, including:

- Clarifying that a description of properties is not necessary if the properties themselves are not material to the company's business;
- In filings that include three years of financial information, permitting the omission of year-to-year comparisons for the earliest year, if (i) the discussion is not material to the company's financial condition, changes in financial condition and results of operations and (ii) the company has filed a prior year Form 10-K on EDGAR that includes a discussion of the earliest of the three years in Management's Discussion and Analysis of Financial Condition and Results of Operations;
- Permitting the description of the company's securities to be included as an exhibit rather than a part of the filed document itself;
- Permitting companies to redact certain confidential information from material contracts included as exhibits without first seeking an order for confidential treatment of the information; and
- Clarifying the rules concerning disclosure of information included in attachments to an agreement filed as an exhibit, and making it clear that personally identifiable information (such as a home address) may be excluded.

These and other proposed changes are subject to a 60 day comment period, and in the normal course would not be effective until sometime next year if they are adopted as proposed.

In the meantime, the SEC Staff has reported that it continues to review other reporting requirements as part of its ongoing disclosure effectiveness project and that additional changes to financial and other reporting requirements might be expected.

Smaller Reporting Companies. In June 2016, the SEC proposed to allow companies with a public market float of up to $250 million to qualify as smaller reporting companies, eligible for certain accommodations in SEC reporting requirements. In its proposal, the SEC did not raise the threshold for the most significant accommodation, however, which is to exempt smaller reporting companies from auditor attestation of their internal control over financial reporting. As a consequence, under the June 2016 proposal, companies with a public market float between $75 million and $250

million would continue to be subject to the Sarbanes-Oxley auditor attestation requirement. Over the next few months, it is expected that the SEC will act on its proposal to increase the public market float to $250 million, but it is unclear whether the SEC will exempt all smaller reporting companies from the auditor attestation requirements.

Status of Dodd-Frank Mandates. The proposed Financial CHOICE Act and an October 2017 U.S. Treasury Department Report[1] are two initiatives to repeal or modify various Dodd-Frank mandates, including CEO pay ratio reporting. The proposed Financial CHOICE Act was approved by the U.S. House of Representatives in June 2017, but has not been approved by the Senate, and it is not clear whether or in what form it might come into law. The U.S. Treasury Department Report advocates the repeal of CEO pay ratio reporting, conflict minerals disclosure and mine safety disclosures. The report suggests that if repeal of these Dodd-Frank mandates does not occur, the SEC could limit their scope by exempting emerging growth companies and smaller reporting companies from their provisions. The SEC has not yet adopted final regulations implementing Dodd-Frank mandates concerning disclosure of policies relating to hedging by employees and directors, pay for performance and listing standards relating to claw-backs of executive compensation.

Other Considerations

Good disclosure helps to tell the company's story and responds to the concerns of investors and regulators. Top of mind items for the coming year include addressing risks such as climate change and cybersecurity. Also important will be disclosures concerning the likely impact of the new GAAP revenue recognition policy, which is effective as of January 1, 2018 for calendar year public companies. The SEC can be expected to continue to comment where companies fail to follow existing SEC guidance on non-GAAP financial disclosures. Companies should also be careful to define and adequately disclose how they calculate key operating metrics such as the number of users or similar statistics.

[1] U.S. Department of Treasury, "A Financial System that Creates Economic Opportunities, Capital Markets," October 2017.

About The Author:

Bonnie Roe has over thirty years of experience as a corporate lawyer advising publicly and privately held companies and funds. Her practice focuses on general corporate law, securities law, mergers and acquisitions, corporate governance, and private equity. Bonnie regularly advises public companies and their boards of directors on public disclosure, SEC compliance matters, corporate governance, and executive compensation. She has served as counsel for issuers, investors, and placement agents in connection with public and private offerings, including cross-border offerings. She also represents companies and investment funds in early and later stage financing transactions and has significant experience in fund formation and investment. Bonnie has counseled numerous buyers and sellers of publicly and privately held businesses, helping to develop and execute strategies for achieving business goals in an efficient manner. Her clients include both U.S. and internationally based companies.

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